Internal Revenue
bulletin

Bulletin No. 2000–49
December 4, 2000

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2000–54, page 566.

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for December 2000.

T.D. 8907, page 558.

Final regulations clarify the tax consequences for the amortization of intangibles under section 197 of the Code in the context of partnership basis adjustments.

Notice 2000–60, page 568.

Stock compensation corporate tax shelter. This notice alerts taxpayers and their representatives that losses generated by transactions involving the purchase of a parent corporation's stock by a subsidiary, a subsequent transfer of the purchased parent stock from the subsidiary to the parent's employees, and the eventual liquidation or sale of the subsidiary are not properly allowable for federal income tax purposes. This notice also alerts taxpayers and their representatives of certain responsibilities that may arise from participation in such transactions.

Notice 2000–61, page 569.

This notice clarifies that section 935 of the Code applies only to individuals and, therefore, does not relieve a trust from any obligation it may have to file an income tax return for the taxable year with the United States. The notice also provides that transactions entered into by taxpayers who claim that section 935 applies to trusts as part of a scheme to avoid both U.S. and Guamanian tax liability are designated as "listed transactions" for purposes of sections 6011, 6111, and 6112 of the Code.

ADMINISTRATIVE

Rev. Proc. 2000–48, page 570.

Optional standard mileage rates. This procedure announces 34.5 cents as the optional rate for deducting or accounting for expenses for business use of an automobile, 14 cents for use of an automobile as a charitable contribution, and 12 cents for use of an automobile as a medical or moving expense for 2001. It provides rules for substantiating the deductible expenses of using an automobile for business, moving, medical, or charitable purposes. Rev. Proc. 99–38 superseded.

Finding Lists begin on page ii.
Index for July through November begins on page iv.

Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62–2: Reimbursements and other expense allowance arrangements.

Rules under which a reimbursement or other expense allowance arrangement for the cost of operating an automobile for business purposes will satisfy the requirements of section 62(c) of the Code as to business connection, substantiation, and returning amounts in excess of expenses. See Rev. Proc. 2000–48, page 570.

Section 162.—Trade or Business Expenses

26 CFR 1.162–17: Reporting and substantiation of certain business expenses of employees.

Rules are set forth for substantiating the amount of a deduction or an expense for business use of an automobile that most nearly represents current costs. See Rev. Proc. 2000–48, page 570.

Section 170.—Charitable, etc., Contributions and Gifts

26 CFR 1.170A–1: Charitable, etc., contributions and gifts; allowance of deduction.

Rules are set forth for substantiating the amount of a deduction or an expense for charitable use of an automobile. See Rev. Proc. 2000–48, page 570.

Section 197.—Amortization of Goodwill and Certain Other Intangibles

26 CFR 1.197–2: Amortization of goodwill and certain other intangibles.

T.D. 8907

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Application of the Anti-Churning Rules for Amortization of Intangibles in Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the amortization of certain intangible property under section 197. Specifically, the regulations apply the anti-churning rules under section 197(f)(9) to partnership distributions resulting in basis adjustments under sections 732(b) and 734(b). This document also amends certain parts of the previously issued final regulations (TD 8865), including those parts that relate to the amount of a basis adjustment under sections 732(d) and 743(b) that is subject to the anti-churning rules under section 197(f)(9). The final regulations interpret the provisions of section 197(f)(9), reflecting changes to the law made by the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), and affect taxpayers who acquired intangible property after August 10, 1993, or made a retroactive election to apply OBRA '93 to intangibles acquired after July 25, 1991.

DATES: *Effective Date*: These regulations are effective November 20, 2000.

Applicability Date: These regulations apply to distributions or transfers occurring on or after November 20, 2000. However, a taxpayer may choose, on a transaction-by-transaction basis, to apply these regulations to property acquired (or partnership transactions occurring) after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T) and before November 20, 2000.

FOR FURTHER INFORMATION CONTACT: David J. Sotos or Robert G. Honigman at (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends §1.197–2 of the Income Tax Regulations (26 CFR Part 1) to provide additional rules regarding the application of section 197(f)(9) to partnership transactions under sections 732(b) and 734(b). This document also amends certain provisions of the final regulations under section 197 issued on January 25, 2000, (TD 8865, 2000–7 I.R.B. 589 [65 F.R. 3820]).

On January 16, 1997, the IRS published proposed regulations (REG–209709–94, 1997–1 C.B. 731) in the **Federal Register** (62 F.R. 2336) under sections 167(f) and 197, including the anti-churning rules in section 197(f)(9). In commenting on the proposed regulations, some practitioners noted that additional guidance was needed regarding how the special anti-churning rule of section 197(f)(9)(E) should apply to increases in the basis of partnership property under sections 732, 734, and 743. In response to these comments, the IRS published proposed regulations (REG–100163–00, 2000–7 I.R.B. 633) in the **Federal Register** (65 F.R. 3903) on January 25, 2000, providing rules for determining the portion of a basis adjustment under sections 732(b) and 734(b) that will be subject to the anti-churning rules. Final regulations (TD 8865, 65 F.R. 3820) (referred to herein as the "existing regulations") were issued at the same time as the proposed regulations. The existing regulations provide guidance regarding the application of the anti-churning rules to basis adjustments under sections 732(d) and 743(b) and to remedial allocations of deductions for amortization of section 197(f)(9) intangibles (i.e., goodwill and going concern value that was held or used at any time during the period beginning on July 25, 1991, and ending on August 10, 1993 (unless an election was made under §1.197–1T) and any other section 197 intangible that was held or used during such period and was not depreciable or amortizable under prior law).

The IRS received no requests to speak at a public hearing that was scheduled for May 24, 2000, and consequently the IRS canceled the hearing. Written comments were received in response to the notice of proposed rulemaking. The comments received and revisions made are discussed below.

Explanation of Provisions and Summary of Comments

A. *In General*

Section 197(f)(9)(E) provides that, in applying the anti-churning rules for basis adjustments under sections 732, 734, and 743, determinations are made at the partner level, and each partner is treated as having owned and used such partner's proportionate share of the partnership's assets. With respect to basis adjustments under sections 732(b) and 734(b), this rule requires taxpayers and the IRS to analyze transactions that actually involve a distribution of property from the partnership to a partner as deemed transactions involving transfers of property directly among the partners. In applying the anti-churning rules to basis adjustments under section 732(b), the distributee partner is deemed to acquire the distributed intangible directly from the continuing partners of the distributing partnership. Similarly, in applying the anti-churning rules to basis adjustments under section 734(b), the continuing partners are deemed to acquire interests in the intangible that remains in the partnership from the partner who received a distribution (giving rise to the section 734(b) basis adjustment) of property other than the intangible.

Consistent with this view of the transactions, §1.197–2(g)(3) of the existing regulations provides that the increase in the basis of a distributed section 197(f)(9) intangible under section 732(b) or the increase in the partnership's basis of an undistributed section 197(f)(9) intangible under section 734(b) is treated as a new intangible acquired as a result of the distribution. The rules for determining whether such basis adjustments are subject to the anti-churning rules under section 197(f)(9) operate by reference to the facts surrounding each partner's acquisition of its interest in the partnership, the relation of the distributee partner and the continuing partners, and the portion of the intangible that is allocable to such partners. Although the specific rules are not phrased in terms of analyzing a deemed transfer of a portion of an intangible between the distributee partner and the continuing partners, the effect of the rules is to analyze such a deemed transfer.

Under the proposed regulations, it first is necessary to determine whether the portion of an intangible that a partner is deemed to acquire as a result of the distribution was subject to the anti-churning rules immediately prior to the deemed transfer. Even if the intangible is a section 197(f)(9) intangible with respect to the partnership, for purposes of analyzing a deemed transfer, the partner's share of the intangible is treated as not being subject to the anti-churning rules if the intangible was held by the partnership at the time that the partner (or predecessor partner) acquired the partnership interest, and the partner (or predecessor partner) would have been able to amortize the intangible had the partner (or predecessor partner) directly acquired the intangible under the same circumstances that the partner (or predecessor partner) acquired the partnership interest. If a partner's share of the intangible is treated as not being subject to the anti-churning rules for this purpose, then the anti-churning rules would not apply to the portion of the basis adjustment that is attributable to the deemed transfer.

If the partner's share of the intangible was treated as being subject to the anti-churning rules immediately prior to the deemed transfer, it is necessary, as a further step, to determine whether the deemed transferor and transferee are related. If the partners are not related, the anti-churning rules would not apply to the basis adjustment that gives rise to the deemed transfer.

The proposed regulations also contain rules for measuring the portion of the intangible that is deemed to be transferred by the relevant partners in the deemed transactions together with certain additional rules designed to prevent circumvention of the anti-churning rules through the use of partnerships.

B. *Continuing Partner's Share of Basis Adjustment Under Section 734(b)*

The proposed regulations provide that, for purposes of analyzing basis adjustments under section 734(b), a continuing partner's share of a basis increase is equal to (1) the total basis increase allocable to the intangible; multiplied by (2) a fraction equal to (A) the unrealized appreciation from the intangible that would have been allocated to the continuing partner if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction; over (B) the total unrealized appreciation from the intangible that would have been realized by the partnership if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction.

One commentator stated that, under the proposed regulations, the fraction for determining a continuing partner's share of the basis adjustment under section 734(b) could lead to inappropriate results in some circumstances. For example, if a partner contributes to a partnership a section 197(f)(9) intangible which has a fair market value that exceeds its tax basis at the time of the contribution, and, at some later date, in an unrelated transaction, the contributing partner is redeemed from the partnership resulting in a section 734(b) adjustment to the intangible, the proposed regulations could determine that the entire adjustment under section 734(b) is allocable to the contributing partner (assuming that the basis adjustment does not exceed the section 704(c) gain attributable to the property), even though the contributing partner is no longer a partner in the partnership.

Treasury and the IRS agree that the fraction used in the proposed regulations can lead to inappropriate results. Furthermore, as discussed below, particularly in situations involving intangibles with built-in gain that are contributed to a partnership, an approach relying on a partner's share of appreciation in an intangible (whether measured before or after a distribution) to determine the partner's share of a basis increase under section 734(b) appears to be inconsistent with the purpose of section 197(f)(9)(E).

Positive basis adjustments under section 734(b) can be analyzed from two different perspectives: gain eliminated or deductions created. Under §1.755–1(c)(2)(i), positive section 734(b) basis adjustments are allocated first to appreciated properties within a class so as to eliminate the built-in gain (and hence section 704(c) gain) with respect to such properties. In analyzing gain on disposition of the asset, the basis adjustment inures first to the benefit of the contributing partner since it will reduce the section 704(c) gain recognized by the partner upon the disposition of the asset by the

partnership. However, in analyzing depreciation or amortization deductions attributable to the asset, the basis will inure first to the non-contributing partners to the extent that they were being denied such deductions as a result of the ceiling rule. In determining the portion of an intangible that a partner is deemed to receive from the distributee partner for purposes of applying the anti-churning rules, it seems that a rule focused on who would receive a deduction as a result of a section 734(b) basis adjustment, rather than who would avoid gain, is more appropriate.

A partner's proportionate share of partnership capital generally serves as a good proxy for estimating a partner's share of deductions. Accordingly, for purposes of determining a continuing partner's share of a section 734(b) basis adjustment, the fraction utilized in the final regulations compares a continuing partner's post-distribution capital account as determined under section 704(b) and §1.704–1(b)(2)(iv) to the aggregate of all of the continuing partners' post-distribution capital accounts (or if the partnership does not maintain capital accounts in accordance with §1.704–1(b)(2)(iv), the fraction is determined by reference to the partner's overall interest in the partnership under §1.704–1(b)(3)). Treasury and the IRS believe this change best reflects how deductions are likely to flow from the intangible asset in a typical partnership arrangement.

C. *Amortization of Section 197(f)(9) Intangible Where Some But Not All of the Basis Adjustment Under Section 734(b) is Amortizable*

The proposed regulations provide that taxpayers may use any reasonable method to determine amortization of a section 734(b) adjustment with respect to an intangible for book purposes, provided that the method does not permit any portion of the tax deduction for amortization attributable to the adjustment to be allocated to a partner who is subject to the anti-churning rules. Several commentators requested guidance as to what methods would be considered reasonable in situations where part, but not all, of a section 734(b) basis adjustment is attributable to an intangible that is subject to the anti-churning rules.

In response to the comments, the final regulations contain an example illustrating one method for determining book amortization that will be considered reasonable under the regulations.

D. *Adjustments Under Sections 743(b) and 732(d) Where the Transferor of the Partnership Interest is Related to the Transferee*

The existing regulations provide that the anti-churning rules apply with respect to positive basis adjustments under section 743(b) only if the person acquiring the partnership interest is related to the person transferring the partnership interest. One commentator pointed out that, even if the transferor partner is related to the transferee partner, there still may be situations where the section 743(b) adjustment should be amortizable by the transferee.

To illustrate the commentator's point, consider the following example: A partnership (PRS) with two partners, A and B, held an intangible subject to the anti-churning rules on August 10, 1993. The partnership has made a section 754 election. On June 1, 1995, A transfers his entire interest in PRS to C, an unrelated person. C has a positive section 743(b) basis adjustment with respect to the intangible that is not subject to the anti-churning rules. On April 30, 2000, C transfers his entire interest in PRS to D, a person related to C. C's section 743(b) basis adjustment disappears as a result of the transfer, and D obtains a new section 743(b) basis adjustment with respect to the intangible. According to the commentator, the ownership of the interest in PRS by C (a party unrelated to A) should permanently purge any taint with respect to a section 743(b) basis adjustment attributable to C's interest. The fact that D is related to C should not prevent D from amortizing the basis adjustment.

The commentator's suggestion is consistent with the aggregate approach in the regulations for adjustments under sections 732(b) and 734(b). Under §1.197–2(h)(12)(ii) and (iv) of these final regulations, if a partner acquires an interest in a partnership from an unrelated partner after August 10, 1993, and after the partnership has acquired the section 197(f)(9) intangible, the partner will be treated as holding a portion of the intangible that is not subject to the anti-churning rules for purposes of analyzing subsequent deemed transfers relating to basis adjustments under sections 732(b) and 734(b). The existing regulations are amended to include similar provisions for purposes of analyzing the application of the anti-churning rules with respect to basis adjustments under section 743(b).

The existing regulations pertaining to section 732(d) adjustments also are amended to coordinate those provisions with the change discussed above for section 743(b) adjustments. The amendment provides that the anti-churning rules do not apply to an increase in the basis of a section 197(f)(9) intangible under section 732(d) if, had an election been in effect under section 754 at the time of the transfer of the partnership interest, the distributee partner would have been able to amortize the basis adjustment made pursuant to section 743(b).

E. *Modification of Rule Where a Partner is or Becomes a User of a Partnership Intangible*

Section 1.197–2(h)(12)(vi) of the proposed regulations provides a rule to prevent avoidance of the anti-churning rules where a partner subject to the anti-churning rules becomes or remains a user of the intangible after the basis of the intangible is adjusted with respect to another partner under section 732, 734, or 743. One commentator noted that §1.197–2(h)(12)(vi) could apply if the partnership itself continues to use the intangible, at least where the deemed transferor of the intangible continues to own more than a 20 percent interest in the partnership, because the partner would be treated under the attribution rules as continuing to use the intangible by virtue of the partnership's use of the intangible. The commentator stated that such a result appears inconsistent with the policies underlying section 197(f)(9)(E), which ignore the existence of the partnership for purposes of anti-churning determinations with respect to basis adjustments under sections 732, 734, and 743. The commentator requested that the final regulations make clear that a partnership's continued use of an intangible would not invoke the rule of §1.197–2(h)(12)(vi).

Consistent with this comment, §1.197–2(h)(12)(vi) of these final regulations makes clear that the proscribed use must be by an anti-churning partner or re-

lated person other than the partnership. Attributed use of the intangible from the partnership to a partner will not cause this rule to apply.

F. *Clarification With Respect to Remedial Allocations*

Section 1.197–2(g)(4)(ii) of the existing regulations provides that "if a partner contributes a section 197 intangible to a partnership and the partnership adopts the remedial allocation method for making section 704(c) allocations of amortization deductions, the partnership generally may make remedial allocations of amortization deductions with respect to the contributed section 197 intangible in accordance with §1.704–3(d)." Comments have been received expressing concern that, because no similar affirmative rule is contained in the anti-churning section of the regulations, if a contributing partner owns a greater than 20 percent interest in the partnership (and thus is considered related to the partnership), the rule allowing remedial allocations will not be available. While Treasury and the IRS believe that it was clear under the existing regulations that remedial allocations of amortization deductions could be made where the contributing partner is related to the partnership (as opposed to the non-contributing partners), an affirmative rule has been added to the anti-churning rules at §1.197–2(h)(12)(vii)(B) in order to eliminate any doubt with respect to this issue.

In addition, the rule regarding the disallowance of remedials where a non-contributing partner is related to the contributing partner is amended in these final regulations to also cover situations where, as part of a series of related transactions that includes the contribution of the section 197(f)(9) intangible to the partnership, the contributing partner (or a related person) becomes or remains a direct user of the contributed intangible. Consistent with the analysis of remedials as being akin to a section 743(b) basis adjustment for the non-contributing partners, Treasury and the IRS believe that it is inappropriate for a non-contributing partner to obtain amortization deductions with respect to a portion of a contributed section 197(f)(9) intangible where the prior owner of the intangible becomes or remains a direct user of the intangible in connection with the contribution. See also section 197(f)(9)(A)(iii) and §1.197–2(h)(12)(vi).

G. *Rules for Determining When a Partnership Interest is Treated as Being Acquired From a Related Person for Purposes of Analyzing Basis Adjustments Under Sections 732(b) and 734(b)*

For purposes of analyzing deemed transfers resulting from basis adjustments under sections 732(b) and 734(b) in applying the anti-churning rules, the proposed regulations provide that if a partner contributed the distributed section 197(f)(9) intangible to the partnership, the partnership interest acquired by such partner is treated as not being described in §1.197–2(h)(12)(ii)(A)(2) and (3) (for section 732(b) adjustments) or 1.197–2(h)(12)(iv)(A)(2) and (3) (for section 734(b) adjustments) (i.e., the rules that allow a prior purchase of a partnership interest from an unrelated person to purge the partner's anti-churning taint in analyzing subsequent deemed transfers relating to basis adjustments). Accordingly, in order for a basis adjustment to a section 197(f)(9) intangible under section 732(b) or 734(b) to be amortizable, the deemed transfer (as a result of the basis adjustment) from the contributing partner must be to an unrelated partner.

Commentators indicated that this rule is unnecessary. According to the commentators, §§1.197–2(h)(12)(ii)(A)(2) and (3) and 1.197–2(h)(12)(iv)(A)(2) and (3), by their terms, cannot apply where the deemed transferor contributed the section 197(f)(9) intangible to the partnership. Treasury and the IRS agree with this comment. Accordingly, the final regulations omit the rule regarding a partner who contributes the distributed section 197(f)(9) intangible.

Special Analyses

It has been determined that the final regulations are not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the final regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are David J. Sotos and Robert G. Honigman of Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and IRS participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.197–2 is amended by:

1. Revising paragraphs (h)(12)(ii), (h)(12)(iii), (h)(12)(iv), (h)(12)(v), and paragraph (h)(12)(vi)(A).

2. Removing ", and" at the end of paragraph (h)(12)(vi)(B)(*2*)(*ii*) and adding a period in its place.

3. Removing paragraph (h)(12)(vi)(B)(*3*).

4. Removing the first sentence of paragraph (h)(12)(vii)(B) and adding two new sentences in its place.

5. Removing the last two sentences of paragraph (iii) of *Example 27* in paragraph (k) and adding three sentences in their place.

6. Adding *Examples 28*, *29*, *30*, and *31* to paragraph (k).

7. Revising paragraphs (l)(1) and (l)(2).

The additions and revisions read as follows:

§1.197–2 Amortization of goodwill and certain other intangibles.

* * * * *

(h) * * *

(12) * * *

(ii) *Section 732(b) adjustments*—(A) *In general*. The anti-churning rules of this paragraph (h) apply to any increase in the adjusted basis of a section 197(f)(9) intangible under section 732(b) to the extent that the basis increase exceeds the total unrealized appreciation from the intangible allocable to—

(*1*) Partners other than the distributee partner or persons related to the distributee partner;

(*2*) The distributee partner and persons related to the distributee partner if the distributed intangible is a section 197(f)(9) intangible acquired by the partnership on or before August 10, 1993, to the extent that—

(*i*) The distributee partner and related persons acquired an interest or interests in the partnership after August 10, 1993;

(*ii*) Such interest or interests were held after August 10, 1993, by a person or persons other than either the distributee partner or persons who were related to the distributee partner; and

(*iii*) The acquisition of such interest or interests by such person or persons was not part of a transaction or series of related transactions in which the distributee partner (or persons related to the distributee partner) subsequently acquired such interest or interests; and

(*3*) The distributee partner and persons related to the distributee partner if the distributed intangible is a section 197(f)(9) intangible acquired by the partnership after August 10, 1993, that is not amortizable with respect to the partnership, to the extent that—

(*i*) The distributee partner and persons related to the distributee partner acquired an interest or interests in the partnership after the partnership acquired the distributed intangible;

(*ii*) Such interest or interests were held after the partnership acquired the distributed intangible, by a person or persons other than either the distributee partner or persons who were related to the distributee partner; and

(*iii*) The acquisition of such interest or interests by such person or persons was not part of a transaction or series of related transactions in which the distributee partner (or persons related to the distributee partner) subsequently acquired such interest or interests.

(B) *Effect of retroactive elections*. For purposes of paragraph (h)(12)(ii)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the relevant party made a valid retroactive election under §1.197–1T.

(C) *Intangible still subject to anti-churning rules*. Notwithstanding paragraph (h)(12)(ii) of this section, in applying the provisions of this paragraph (h) with respect to subsequent transfers, the distributed intangible remains subject to the provisions of this paragraph (h) in proportion to a fraction (determined at the time of the distribution), as follows—

(*1*) The numerator of which is equal to the sum of—

(*i*) The amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section; and

(*ii*) The total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply; and

(*2*) The denominator of which is the fair market value of such intangible.

(D) *Partner's allocable share of unrealized appreciation from the intangible*. The amount of unrealized appreciation from an intangible that is allocable to a partner is the amount of taxable gain that would have been allocated to that partner if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction.

(E) *Acquisition of partnership interest by contribution*. Solely for purposes of paragraphs (h)(12)(ii)(A)(*2*) and (*3*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each partner's respective proportionate interest in the partnership.

(iii) *Section 732(d) adjustments*. The anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197(f)(9) intangible under section 732(d) if, had an election been in effect under section 754 at the time of the transfer of the partnership interest, the distributee partner would have been able to amortize the basis adjustment made pursuant to section 743(b).

(iv) *Section 734(b) adjustments*—(A) *In general*. The anti- churning rules of this paragraph (h) do not apply to a continuing partner's share of an increase in the basis of a section 197(f)(9) intangible held by a partnership under section 734(b) to the extent that the continuing partner is an eligible partner.

(B) *Eligible partner*. For purposes of this paragraph (h)(12)(iv), eligible partner means—

(*1*) A continuing partner that is not the distributee partner or a person related to the distributee partner;

(*2*) A continuing partner that is the distributee partner or a person related to the distributee partner, with respect to any section 197(f)(9) intangible acquired by the partnership on or before August 10, 1993, to the extent that—

(*i*) The distributee partner's interest in the partnership was acquired after August 10, 1993;

(*ii*) Such interest was held after August 10, 1993 by a person or persons who were not related to the distributee partner; and

(*iii*) The acquisition of such interest by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest; or

(*3*) A continuing partner that is the distributee partner or a person related to the distributee partner, with respect to any section 197(f)(9) intangible acquired by the partnership after August 10, 1993, that is not amortizable with respect to the partnership, to the extent that—

(*i*) The distributee partner's interest in the partnership was acquired after the partnership acquired the relevant intangible;

(*ii*) Such interest was held after the partnership acquired the relevant intangible by a person or persons who were not related to the distributee partner; and

(*iii*) The acquisition of such interest by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest.

(C) *Effect of retroactive elections*. For purposes of paragraph (h)(12)(iv)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the distributee partner made a valid retroactive election under §1.197–1T.

(D) *Partner's share of basis increase*—(*1*) *In general*. Except as provided in paragraph (h)(12)(iv)(D)(*2*) of this section, for purposes of this paragraph

(h)(12)(iv), a continuing partner's share of a basis increase under section 734(b) is equal to—

(*i*) The total basis increase allocable to the intangible; multiplied by

(*ii*) A fraction the numerator of which is the amount of the continuing partner's post-distribution capital account (determined immediately after the distribution in accordance with the capital accounting rules of §1.704–1(b)(2)(iv)), and the denominator of which is the total amount of the post-distribution capital accounts (determined immediately after the distribution in accordance with the capital accounting rules of §1.704–1(b)(2)(iv)) of all continuing partners.

(*2*) *Exception where partnership does not maintain capital accounts.* If a partnership does not maintain capital accounts in accordance with §1.704–1(b)(2)(iv), then for purposes of this paragraph (h)(12)(iv), a continuing partner's share of a basis increase is equal to—

(*i*) The total basis increase allocable to the intangible; multiplied by

(*ii*) The partner's overall interest in the partnership as determined under §1.704–1(b)(3) immediately after the distribution.

(E) *Interests acquired by contribution*—(*1*) *Application of paragraphs (h)(12)(iv)(B)(2) and (3) of this section.* Solely for purposes of paragraphs (h)(12)(iv)(B)(*2*) and (*3*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each such partner's proportionate interest in the partnership.

(*2*) *Special rule with respect to paragraph (h)(12)(iv)(B)(1) of this section.* Solely for purposes of paragraph (h)(12)(iv)(B)(*1*) of this section, if a distribution that gives rise to an increase in the basis under section 734(b) of a section 197(f)(9) intangible held by the partnership is undertaken as part of a series of related transactions that include a contribution of the intangible to the partnership by a continuing partner, the continuing partner is treated as related to the distributee partner in analyzing the basis adjustment with respect to the contributed section 197(f)(9) intangible.

(F) *Effect of section 734(b) adjustments on partners' capital accounts.* If one or more partners are subject to the anti-churning rules under this paragraph (h) with respect to a section 734(b) adjustment allocable to an intangible asset, taxpayers may use any reasonable method to determine amortization of the asset for book purposes, provided that the method used does not contravene the purposes of the anti-churning rules under section 197 and this paragraph (h). A method will be considered to contravene the purposes of the anti-churning rules if the effect of the book adjustments resulting from the method is such that any portion of the tax deduction for amortization attributable to the section 734 adjustment is allocated, directly or indirectly, to a partner who is subject to the anti-churning rules with respect to such adjustment.

(v) *Section 743(b) adjustments*—(A) *General Rule.* The anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197 intangible under section 743(b) if the person acquiring the partnership interest is not related to the person transferring the partnership interest. In addition, the anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197 intangible under section 743(b) to the extent that—

(*1*) The partnership interest being transferred was acquired after August 10, 1993, provided—

(*i*) The section 197(f)(9) intangible was acquired by the partnership on or before August 10, 1993;

(*ii*) The partnership interest being transferred was held after August 10, 1993, by a person or persons (the post-1993 person or persons) other than the person transferring the partnership interest or persons who were related to the person transferring the partnership interest; and

(*iii*) The acquisition of such interest by the post-1993 person or persons was not part of a transaction or series of related transactions in which the person transferring the partnership interest or persons related to the person transferring the partnership interest acquired such interest; or

(*2*) The partnership interest being transferred was acquired after the partnership acquired the section 197(f)(9) intangible, provided—

(*i*) The section 197(f)(9) intangible was acquired by the partnership after August 10, 1993, and is not amortizable with respect to the partnership;

(*ii*) The partnership interest being transferred was held after the partnership acquired the section 197(f)(9) intangible by a person or persons (the post-contribution person or persons) other than the person transferring the partnership interest or persons who were related to the person transferring the partnership interest; and

(*iii*) The acquisition of such interest by the post-contribution person or persons was not part of a transaction or series of related transactions in which the person transferring the partnership interest or persons related to the person transferring the partnership interest acquired such interest.

(B) *Acquisition of partnership interest by contribution.* Solely for purposes of paragraph (h)(12)(v)(A)(*1*) and (*2*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each such partner's proportionate interest in the partnership.

(C) *Effect of retroactive elections.* For purposes of paragraph (h)(12)(v)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the transferee partner made a valid retroactive election under §1.197–1T.

(vi) *Partner is or becomes a user of partnership intangible*—(A) *General rule.* If, as part of a series of related transactions that includes a transaction described in paragraph (h)(12)(ii), (iii), (iv), or (v) of this section, an anti-churning partner or related person (other than the partnership) becomes (or remains) a direct user of an intangible that is treated as transferred in the transaction (as a result of the partners being treated as having owned their proportionate share of partnership assets), the anti-churning rules of this paragraph (h) apply to the proportionate share of such intangible that is treated as transferred by such anti-churning partner, notwithstanding the application of paragraph (h)(12)(ii), (iii), (iv), or (v) of this section.

* * * * *

(vii)* * *

(B) *Allocations where the intangible is not amortizable by the contributor*. If a section 197(f)(9) intangible was not an amortizable section 197 intangible in the hands of the contributing partner, a noncontributing partner generally may receive remedial allocations of amortization under section 704(c) that are deductible for Federal income tax purposes. However, such a partner may not receive remedial allocations of amortization under section 704(c) if that partner is related to the partner that contributed the intangible or if, as part of a series of related transactions that includes the contribution of the section 197(f)(9) intangible to the partnership, the contributing partner or related person (other than the partnership) becomes (or remains) a direct user of the contributed intangible.* * *

* * * * *

(k) * * *

Example 27. * * *

(iii) * * * However, A is an anti-churning partner under paragraph (h)(12)(vi)(B)(*2*)(*i*) of this section. As a result of the license agreement, A remains a direct user of the section 197(f)(9) intangible after the transfer to C. Accordingly, paragraph (h)(12)(vi)(A) of this section will cause the anti-churning rules to apply to the entire basis adjustment under section 743(b).

Example 28. Distribution of section 197(f)(9) intangible to partner who acquired partnership interest prior to the effective date. (i) In 1990, A, B, and C each contribute $150 cash to form general partnership ABC for the purpose of engaging in a consulting business and a software manufacturing business. The partners agree to share partnership profits and losses equally. In 2000, the partnership distributes the consulting business to A in liquidation of A's entire interest in ABC. The only asset of the consulting business is a nonamortizable intangible, which has a fair market value of $180 and a basis of $0. At the time of the distribution, the adjusted basis of A's interest in ABC is $150. A is not related to B or C. ABC does not have a section 754 election in effect.

(ii) Under section 732(b), A's adjusted basis in the intangible distributed by ABC is $150, a $150 increase over the basis of the intangible in ABC's hands. In determining whether the anti-churning rules apply to any portion of the basis increase, A is treated as having owned and used A's proportionate share of partnership property. Thus, A is treated as holding an interest in the intangible during the transition period. Because the intangible was not amortizable prior to the enactment of section 197, the section 732(b) increase in the basis of the intangible may be subject to the anti-churning provisions. Paragraph (h)(12)(ii) of this section provides that the anti-churning provisions apply to the extent that the section 732(b) adjustment exceeds the total unrealized appreciation from the intangible allocable to partners other than A or persons related to A, as well as certain other partners whose purchase of their interests meet certain criteria. Because B and C are not related to A, and A's acquisition of its partnership interest does not satisfy the necessary criteria, the section 732(b) basis increase is subject to the anti-churning provisions to the extent that it exceeds B and C's proportionate share of the unrealized appreciation from the intangible. B and C's proportionate share of the unrealized appreciation from the intangible is $120 (2/3 of $180). This is the amount of gain that would be allocated to B and C if the partnership sold the intangible immediately before the distribution for its fair market value of $180. Therefore, $120 of the section 732(b) basis increase is not subject to the anti-churning rules. The remaining $30 of the section 732(b) basis increase is subject to the anti-churning rules. Accordingly, A is treated as having two intangibles, an amortizable section 197 intangible with an adjusted basis of $120 and a new amortization period of 15 years and a nonamortizable intangible with an adjusted basis of $30.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-third of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($0) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($180 - $120 = $60), over the fair market value of the distributed intangible ($180).

Example 29. Distribution of section 197(f)(9) intangible to partner who acquired partnership interest after the effective date. (i) The facts are the same as in *Example 28*, except that B and C form ABC in 1990. A does not acquire an interest in ABC until 1995. In 1995, A contributes $150 to ABC in exchange for a one-third interest in ABC. At the time of the distribution, the adjusted basis of A's interest in ABC is $150.

(ii) As in *Example 28*, the anti-churning rules do not apply to the increase in the basis of the intangible distributed to A under section 732(b) to the extent that it does not exceed the unrealized appreciation from the intangible allocable to B and C. Under paragraph (h)(12)(ii) of this section, the anti-churning provisions also do not apply to the section 732(b) basis increase to the extent of A's allocable share of the unrealized appreciation from the intangible because A acquired the ABC interest from an unrelated person after August 10, 1993, and the intangible was acquired by the partnership before A acquired the ABC interest. Under paragraph (h)(12)(ii)(E) of this section, A is deemed to acquire the ABC partnership interest from an unrelated person because A acquired the ABC partnership interest in exchange for a contribution to the partnership of property other than the distributed intangible and, at the time of the contribution, no partner in the partnership was related to A. Consequently, the increase in the basis of the intangible under section 732(b) is not subject to the anti-churning rules to the extent of the total unrealized appreciation from the intangible allocable to A, B, and C. The total unrealized appreciation from the intangible allocable to A, B, and C is $180 (the gain the partnership would have recognized if it had sold the intangible for its fair market value immediately before the distribution). Because this amount exceeds the section 732(b) basis increase of $150, the entire section 732(b) basis increase is amortizable.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-sixth of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($0) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($180 - $150 = $30), over the fair market value of the distributed intangible ($180).

Example 30. Distribution of section 197(f)(9) intangible contributed to the partnership by a partner. (i) The facts are the same as in *Example 29*, except that C purchased the intangible used in the consulting business in 1988 for $60 and contributed the intangible to ABC in 1990. At that time, the intangible had a fair market value of $150 and an adjusted tax basis of $60. When ABC distributes the intangible to A in 2000, the intangible has a fair market value of $180 and a basis of $60.

(ii) As in *Examples 28* and *29*, the adjusted basis of the intangible in A's hands is $150 under section 732(b). However, the increase in the adjusted basis of the intangible under section 732(b) is only $90 ($150 adjusted basis after the distribution compared to $60 basis before the distribution). Pursuant to paragraph (g)(2)(ii)(B) of this section, A steps into the shoes of ABC with respect to the $60 of A's adjusted basis in the intangible that corresponds to ABC's basis in the intangible and this portion of the basis is nonamortizable. B and C are not related to A, A acquired the ABC interest from an unrelated person after August 10, 1993, and the intangible was acquired by ABC before A acquired the ABC interest. Therefore, under paragraph (h)(12)(ii) of this section, the section 732(b) basis increase is amortizable to the extent of A, B, and C's allocable share of the unrealized appreciation from the intangible. The total unrealized appreciation from the intangible that is allocable to A, B, and C is $120. If ABC had sold the intangible immediately before the distribution to A for its fair market value of $180, it would have recognized gain of $120, which would have been allocated $10 to A, $10 to B, and $100 to C under section 704(c). Because A, B, and C's allocable share of the unrealized appreciation from the intangible exceeds the section 732(b) basis increase in the intangible, the entire $90 of basis increase is amortizable by A. Accordingly, after the distribution, A will be treated as having two intangibles, an amortizable section 197 intangible with an adjusted basis of $90 and a new amortization period of 15 years and a nonamortizable intangible with an adjusted basis of $60.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-half of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that

is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($60) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($120 - $90 = $30), over the fair market value of the distributed intangible ($180).

Example 31. Partnership distribution causing section 734(b) basis adjustment to section 197(f)(9) intangible. (i) On January 1, 2001, A, B, and C form a partnership (ABC) in which each partner shares equally in capital and income, gain, loss, and deductions. On that date, A contributes a section 197(f)(9) intangible with a zero basis and a value of $150, and B and C each contribute $150 cash. A and B are related, but neither A nor B is related to C. ABC does not adopt the remedial allocation method for making section 704(c) allocations of amortization expenses with respect to the intangible. On December 1, 2004, when the value of the intangible has increased to $600, ABC distributes $300 to B in complete redemption of B's interest in the partnership. ABC has an election under section 754 in effect for the taxable year that includes December 1, 2004. (Assume that, at the time of the distribution, the basis of A's partnership interest remains zero, and the basis of each of B's and C's partnership interest remains $150.)

(ii) Immediately prior to the distribution, the assets of the partnership are revalued pursuant to §1.704–1(b)(2)(iv)(*f*), so that the section 197(f)(9) intangible is reflected on the books of the partnership at a value of $600. B recognizes $150 of gain under section 731(a)(1) upon the distribution of $300 in redemption of B's partnership interest. As a result, the adjusted basis of the intangible held by ABC increases by $150 under section 734(b). A does not satisfy any of the tests set forth under paragraph (h)(12)(iv)(B) and thus is not an eligible partner. C is not related to B and thus is an eligible partner under paragraph (h)(12)(iv)(B)(*1*) of this section. The capital accounts of A and C are equal immediately after the distribution, so, pursuant to paragraph (h)(12)(iv)(D)(*1*) of this section, each partner's share of the basis increase is equal to $75. Because A is not an eligible partner, the anti-churning rules apply to A's share of the basis increase. The anti-churning rules do not apply to C's share of the basis increase.

(iii) For book purposes, ABC determines the amortization of the asset as follows: First, the intangible that is subject to adjustment under section 734(b) will be divided into three assets: the first, with a basis and value of $75 will be amortizable for both book and tax purposes; the second, with a basis and value of $75 will be amortizable for book, but not tax purposes; and a third asset with a basis of zero and a value of $450 will not be amortizable for book or tax purposes. Any subsequent revaluation of the intangible pursuant to §1.704–1(b)(2)(iv)(*f*) will be made solely with respect to the third asset (which is not amortizable for book purposes). The book and tax attributes from the first asset (i.e., book and tax amortization) will be specially allocated to C. The book and tax attributes from the second asset (i.e., book amortization and non-amortizable tax basis) will be specially allocated to A. Upon disposition of the intangible, each partner's share of gain or loss will be determined first by allocating among the partners an amount realized equal to the book value of the intangible attributable to such partner, with any remaining amount realized being allocated in accordance with the partnership agreement. Each partner then will compare its share of the amount realized with its remaining basis in the intangible to arrive at the gain or loss to be allocated to such partner. This is a reasonable method for amortizing the intangible for book purposes, and the results in allocating the income, gain, loss, and deductions attributable to the intangible do not contravene the purposes of the anti-churning rules under section 197 or paragraph (h) of this section.

(l) * * *(1) *In general*. This section applies to property acquired after January 25, 2000, except that paragraph (c)(13) of this section (exception from section 197 for separately acquired rights of fixed duration or amount) applies to property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T), and paragraphs (h)(12)(ii), (iii), (iv), (v), (vi)(A), and (vii)(B) of this section (anti-churning rules applicable to partnerships) apply to partnership transactions occurring on or after November 20, 2000.

(2) *Application to pre-effective date acquisitions*. A taxpayer may choose, on a transaction-by-transaction basis, to apply the provisions of this section and §1.167(a)–14 to property acquired (or partnership transactions occurring) after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T) and—

(i) On or before January 25, 2000; or

(ii) With respect to paragraphs (h)(12)(ii), (iii), (iv), (v), (vi)(A), and (vii)(B) of this section, before November 20, 2000.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue Service.

Approved November 9, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 17, 2000, 8:45 a.m., and published in the issue of the Federal Register for November 20, 2000, 65 F.R. 69667)

Section 213.—Medical, Dental, etc., Expenses

26 CFR 1.213–1: Medical, dental, etc., expenses.

Rules are set forth for substantiating the amount of a deduction or an expense for use of an automobile to obtain medical services. See Rev. Proc. 2000–48, page 570.

Section 217.—Moving Expenses

26 CFR 1.217–2: Moving expenses.

Rules are set forth for substantiating the amount of a deduction or an expense for use of an automobile as part of a move. See Rev. Proc. 2000–48, page 570.

Section 274.—Disallowance of Certain Entertainment, etc., Expenses

26 CFR 1.274–5: Substantiation requirements.

Rules are set forth for an optional method for substantiating the amount of ordinary and necessary business expenses of an employee for automobile expenses when a payor provides a mileage allowance for such expenses. Rules are also set forth for an optional method for employees and self-employed individuals to use in substantiating a trade or business deduction for automobile expenses. See Rev. Proc. 2000–48, page 570.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, on this page.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, on this page.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, on this page.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, on this page.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, on this page.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for December 2000.

Rev. Rul. 2000-54

This revenue ruling provides various prescribed rates for federal income tax purposes for December 2000 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the 2001 interest rate for purposes of sections 846 and 807.

REV. RUL. 2000–54 TABLE 1

Applicable Federal Rates (AFR) for December 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	6.10%	6.01%	5.97%	5.94%
110% AFR	6.72%	6.61%	6.56%	6.52%
120% AFR	7.34%	7.21%	7.15%	7.10%
130% AFR	7.96%	7.81%	7.74%	7.69%
Mid-Term				
AFR	5.87%	5.79%	5.75%	5.72%
110% AFR	6.47%	6.37%	6.32%	6.29%
120% AFR	7.07%	6.95%	6.89%	6.85%
130% AFR	7.67%	7.53%	7.46%	7.41%
150% AFR	8.88%	8.69%	8.60%	8.54%
175% AFR	10.39%	10.13%	10.00%	9.92%
Long-Term				
AFR	5.98%	5.89%	5.85%	5.82%
110% AFR	6.58%	6.48%	6.43%	6.39%
120% AFR	7.19%	7.07%	7.01%	6.97%
130% AFR	7.81%	7.66%	7.59%	7.54%

REV. RUL. 2000–54 TABLE 2

Adjusted AFR for December 2000

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.30%	4.25%	4.23%	4.21%
Mid-term adjusted AFR	4.58%	4.53%	4.50%	4.49%
Long-term adjusted AFR	5.31%	5.24%	5.21%	5.18%

REV. RUL. 2000–54 TABLE 3

Rates Under Section 382 for December 2000

Adjusted federal long-term rate for the current month	5.31%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.39%

REV. RUL. 2000–54 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for December 2000

Appropriate percentage for the 70% present value low-income housing credit	8.39%
Appropriate percentage for the 30% present value low-income housing credit	3.59%

REV. RUL. 2000–54 TABLE 5

Rate Under Section 7520 for December 2000

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.0%

REV. RUL. 2000–54 TABLE 6

Rate Under Sections 846 and 807

Applicable rate of interest for 2001 for purposes of sections 846 and 807	6.00%

Section 1288.—Treatment of Original Issue Discounts on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

Stock Compensation Corporate Tax Shelter

Notice 2000–60

The Internal Revenue Service and the Treasury Department have become aware of certain types of transactions, as described below, that are being marketed to taxpayers for the avoidance of federal income taxes. The IRS and Treasury are issuing this notice to alert taxpayers and their representatives that the losses generated by such transactions are not properly allowable for federal income tax purposes and also to alert them of certain responsibilities that may arise from participation in such transactions.

FACTS

These transactions generally involve three parties: a domestic corporation (P) that is the common parent of a consolidated group, a domestic subsidiary (S), and a third party (X) that either is unrelated to P or is related but is not an includible corporation within the meaning of § 1504(b) of the Internal Revenue Code. P and X transfer cash to S in exchange for S's stock. After this exchange, P owns stock representing less than 80 percent of the voting power of S's stock, thus preventing S from being a member of P's consolidated group. X owns preferred stock of S. P's and X's basis in their S stock reflects the amount of cash they contributed to S. S uses the cash to purchase stock of P from P's shareholders. From time to time, S transfers P shares to P employees in satisfaction of P's stock-based employee compensation obligations (*e.g.*, upon the exercise by an employee of a non-statutory option to purchase P stock). In a few years, S will sell any remaining P stock, and then S will liquidate or P will sell its S stock.

Notwithstanding that P is the majority shareholder of S, P and S take the position that S's transfers of P stock to P's employees must be treated, under § 1.83–6(d) of the Income Tax Regulations, as deemed capital contributions by S to P followed by transfers by P to the P employees. P does not reduce its basis in its S stock as a result of S's deemed transfers to P. S increases its basis in its remaining P stock by the amount of the basis of the P shares S transferred in the deemed capital contributions to P. Under § 1032, P reports no gain or loss from the deemed transfers of P stock to P's employees. P takes deductions under § 83(h) in the amount that the P employees include in income under § 83(a) from their receipt of the P stock.

When S liquidates or P sells its S stock, P claims a capital loss under § 331 or § 1001 because S has already transferred most of its P stock to the P employees, which has substantially reduced the value of S without a corresponding downward adjustment in P's basis in its S stock. Because S claims to have shifted all of its basis in the P stock to S's shares of P stock remaining after the transfers to the P employees, S also reports a capital loss on the sale of its remaining P stock immediately before S's liquidation or sale.

ANALYSIS

When a corporation makes a payment that discharges a liability of its shareholder, the discharge of the liability is treated as a distribution to the shareholder with respect to the shareholder's stock. *See, e.g., Tennessee Securities Inc. v. Commissioner*, 674 F.2d 570, 573 (6th Cir. 1982), *citing Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929). To permit a controlled subsidiary to avoid distribution treatment for transfers made on behalf of a parent corporation merely by purchasing some shares of the parent corporation's stock would contravene the framework governing distributions under § 301. Moreover, to characterize such transfers as capital contributions made by the subsidiary in its capacity as a shareholder of the parent corporation would be inconsistent with the substance of these transactions. The characterization in § 1.83– 6(d) of a shareholder's transfer of property to a corporation's employees as a deemed capital contribution only applies when the transferor is acting in its capacity as a shareholder. That characterization is inapposite when the transferee is a controlling corporate shareholder of the transferor, and the transferor subsidiary has no plausible investment motive for making such transfers.

The transfers by S to the P employees are properly characterized as distributions by S to P with respect to P's S stock, subject to the rules of §§ 301 and 311, followed by compensatory transfers by P to P's employees. Distributions to the extent of earnings and profits result in dividend treatment under § 301(c)(1). To the extent that the amount of the distributions exceeds the earnings and profits of S, the distributions reduce P's basis in its S stock under § 301(c)(2), thus reducing or eliminating P's purported loss with respect to the S stock upon S's liquidation or sale. In addition, because the transfers of P stock by S to P are distributions and not capital contributions, S is not permitted to shift basis from the transferred P stock to S's remaining P stock and, therefore, S does not have a capital loss on the sale of its remaining P stock immediately before S's liquidation or sale.

Alternatively, the IRS may disregard the described steps and treat the transaction as a redemption by P. It is a well-established principle of tax law that when transactions lack a legitimate business purpose and are undertaken solely for tax avoidance purposes, their tax consequences will be determined based on substance and not form. *Gregory v. Helvering*, 293 U.S. 465 (1935). The transfer of cash from P to S, the purchase by S of P stock from P shareholders, the transfers by S of P stock to P's employees, and the ultimate liquidation or sale of S, all pursuant to the same arrangement, may be disregarded for tax purposes and, instead, be treated as a redemption by P of its stock followed by compensatory transfers of treasury stock by P to its employees. No deduction is permitted for amounts paid to redeem stock. *See* § 162(k).

It is also well-established that, to be allowable, a loss must be bona fide and must reflect actual economic consequences in order to be sustained. An artificial loss lacking economic substance is not allowable. *See* § 165(a); *ACM Partnership v. Commissioner*, 157 F.3d 231, 252 (3d Cir. 1998), *cert. denied*, 526 U.S. 1017 (1999) ("Tax losses such as these . . . which do not correspond to any actual economic losses, do not constitute the type of 'bona fide' losses that are deductible under the Internal Revenue Code and regulations."); Treas. Reg. § 1.165-1(b) ("Only a bona

fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss."). This transaction is no more than a series of contrived steps that effect an artificial loss on P's disposition of S stock. Consequently, the arrangement described above, or any similar arrangement, does not produce an allowable loss.

The purported tax benefits from these transactions may also be subject to challenge for other reasons, including other provisions of the Code and the regulations, such as § 269.

Additionally, the Service may impose penalties on participants in these transactions, or, as applicable, on persons who participate in the promotion or reporting of these transactions, including the accuracy-related penalty under § 6662, the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701.

Transactions that are the same as or substantially similar to those described in this Notice 2000–60 are identified as "listed transactions" for the purposes of § 1.6011–4T(b)(2) of the Temporary Income Tax Regulations and § 301.6111–2T(b)(2) of the Temporary Procedure and Administration Regulations. *See also* § 301.6112–1T, A–4. It should be noted that independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), such transactions may already be subject to the tax shelter registration and list maintenance requirements of §§ 6111 and 6112 under the regulations issued in February 2000 (§§ 301.6111–2T and 301.6112–1T, A-4), as well as the regulations issued in 1984 and amended in 1986 (§§ 301.6111–1T and 301.6112–1T, A-3). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under § 6707(a) and to the penalty under § 6708(a) if the requirements of § 6112 are not satisfied.

The principal author of this notice is Megan Fitzsimmons of the Office of the Associate Chief Counsel (Corporate). For further information regarding this notice, contact Ms. Fitzsimmons at 202-622-7790 (not a toll-free call).

Trusts Not Considered Individuals for Purposes of Section 935

Notice 2000–61

The Internal Revenue Service and the Treasury Department have become aware of certain types of transactions that are being marketed to taxpayers for the avoidance of federal income taxes. The promoters of these transactions claim that section 935 applies to a trust as part of a scheme in which the trust seeks effectively to avoid both U.S. and Guamanian tax liability. As explained below, section 935 applies to individuals only and not to trusts. These transactions may also be subject to challenge on other grounds. In addition, such transactions are hereby designated as "listed transactions" for purposes of sections 6011, 6111 and 6112.

Prior to 1973, U.S. citizens who were residents of Guam, and whose citizen status did not derive from birth or naturalization in Guam, were required to file both U.S. and Guamanian tax returns. H.R. Rep. No. 92–1479, 92d Cong., 2d Sess. 1 (1972); *see also* Section 31 of the Organic Act of Guam, 48 U.S.C. § 1421 *et seq*. In addition, most other individuals who derived income from both Guam and the United States had to file tax returns with both jurisdictions. *Id*.

Section 935 was enacted, effective for tax years beginning after 1972, to permit such individuals to file a single income tax return, in Guam, thus eliminating the administrative burdens associated with the filing of two income tax returns. It was recognized that the foreign tax credit generally eliminated the tax liability to one of the jurisdictions and, therefore, that section 935 generally would not affect the amount of tax ultimately due. *See* H.R. Rep. No. 92–1479, 92d Cong., 2d Sess. 1 (1972). Section 935 was repealed by P.L. 99–514, sec. 1272(d)(2) (1986), but the repeal takes effect only if (and for so long as) an implementing agreement under P.L. 99–514, section 1271, is in force between the United States and Guam. No such implementing agreement is in force, and thus section 935 remains in effect.

The single filing rule contained in section 935 applies solely to individuals who are resident in Guam, individuals who are citizens of Guam and are not otherwise citizens of the United States, individuals who are U.S. citizens or residents and have income derived from Guam, and individuals who file joint returns with any of these persons.

Nothing in the language of section 935, its legislative history, or the policy behind its enactment indicates that a trust is to be considered an individual for purposes of section 935. The fact that under section 641(b) the taxable income of a trust is generally determined in the same manner as the taxable income of an individual has no bearing on whether a trust is an individual for purposes of section 935. Section 935 does not relieve a trust from any obligation it may have to file an income tax return for the taxable year with the United States and to pay to the United States any tax due.

Transactions in which it is claimed that section 935 applies to a trust as part of a scheme in which the trust seeks effectively to avoid both U.S. and Guamanian tax liability may also be subject to challenge on other grounds.

The Service may impose penalties on participants in transactions subject to this Notice, or, as applicable, on persons who participate in the promotion or reporting of these transactions, including the accuracy-related penalty under section 6662, the return preparer penalty under section 6694, the promoter penalty under section 6700, and the aiding and abetting penalty under section 6701. Failure to file penalties under section 6651 on the trust may also be appropriate.

In addition, transactions subject to this Notice are hereby identified as "listed transactions" for the purposes of § 1.6011–4T(b)(2) of the Temporary Income Tax Regulations, to the extent applicable, and § 301.6111–2T(b)(2) of the Temporary Procedure and Administration Regulations. *See* also § 301.6112–1T, A-4. It should be noted that independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), such transactions may already be subject to the tax shelter registration and list maintenance requirements of sections 6111 and 6112 under the regulations issued in February 2000

(§§ 301.6111–2T and 301.6112–1T, A-4). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under section 6707(a) and to the penalty under section 6708(a) if the requirements of section 6112 are not satisfied.

The principal author of this notice is Karen A. Rennie-Quarrie of the Office of Associate Chief Counsel (International). For further information regarding this notice contact Ms. Rennie-Quarrie at (202) 622-3880 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, Sections 62, 162, 170, 213, 217, 274, 1016; 1.62–2, 1.162–17, 1.170A–1, 1.213–1, 1.217–2, 1.274–5, 1.1016–3.)

Rev. Proc. 2000–48

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 99–38, 1999–43 I.R.B. 525, by providing optional standard mileage rates for employees, self-employed individuals, or other taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. This revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee will be deemed substantiated under § 1.274–5 of the Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation.

SECTION 2. SUMMARY OF STANDARD MILEAGE RATES

.01 *Standard mileage rates.*

(1) Business (section 5 below)	34.5 cents per mile
(2) Charitable (section 7 below)	14 cents per mile
(3) Medical and Moving (section 7 below)	12 cents per mile

.02 *Determination of standard mileage rates*. The business, medical, and moving standard mileage rates reflected in this revenue procedure are based on an annual study of the fixed and variable costs of operating an automobile conducted on behalf of the Service by an independent contractor, and the charitable standard mileage rate is provided in § 170(i) of the Internal Revenue Code.

SECTION 3. BACKGROUND

.01 Section 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct the cost of operating an automobile to the extent that it is used in a trade or business. However, under § 262, no portion of the cost of operating an automobile that is attributable to personal use is deductible.

.02 Section 274(d) provides, in part, that no deduction shall be allowed under § 162 with respect to any listed property (as defined in § 280F(d)(4) to include passenger automobiles and any other property used as a means of transportation) unless the taxpayer complies with certain substantiation requirements. The section further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by such regulations.

.03 Section 1.274–5(j), in part, grants the Commissioner the authority to establish a method under which a taxpayer may use mileage rates to substantiate, for purposes of § 274(d), the amount of the ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home.

.04 Section 1.274–5(g), in part, grants the Commissioner the authority to prescribe rules relating to mileage allowances for ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which such allowances, if in accordance with reasonable business practice, will be regarded as (1) equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel and transportation expenses for purposes of § 1.274–5(c), and (2) satisfying the requirements of an adequate accounting to the employer of the amount of such expenses for purposes of § 1.274–5(f).

.05 Section 62(a)(2)(A) allows an employee, in determining adjusted gross income, a deduction for the expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement. Section 62(c) further provides that the substantiation requirements described therein shall not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for such expense.

.07 Under § 1.62–2(c)(1), a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. Section 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274–5(g) will be treated as substantiation of the amount of such expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an arrangement providing mileage allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of such an allowance that relates to miles of travel substantiated and that exceeds the amount

of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance that relates to miles of travel not substantiated.

.08 Section 1.62–2(h)(2)(i)(B) provides that if a payor pays a mileage allowance under an arrangement that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to miles of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under § 274(d) and § 1.274–5(g), and that the employee is not required to return, is subject to withholding and payment of employment taxes. *See* §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this excess portion.

.09 Under § 1.62–2(h)(2)(i)(B)(4), the Commissioner may, in his or her discretion, prescribe special rules regarding the timing of withholding and payment of employment taxes on mileage allowances.

SECTION 4. DEFINITIONS

.01 *Standard mileage rate*. The term "standard mileage rate" means the applicable amount provided by the Service for optional use by employees or self-employed individuals in computing the deductible costs of operating automobiles (including vans, pickups, or panel trucks) owned or leased for business purposes, or by taxpayers in computing the deductible costs of operating automobiles for charitable, medical, or moving expense purposes.

.02 *Transportation expenses*. The term "transportation expenses" means the expenses of operating an automobile for local travel or transportation away from home.

.03 *Mileage allowance*. The term "mileage allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62–2(c)(1) and that is

(1) paid with respect to the ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for transportation expenses in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at the applicable standard mileage rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.04 *Flat rate or stated schedule*. A mileage allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 4.03 of this revenue procedure. Such allowance may be paid periodically at a fixed rate, at a cents-per-mile rate, at a variable rate based on a stated schedule, at a rate that combines any of these rates, or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, a periodic payment at a fixed rate to cover the fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving an automobile in connection with the performance of services as an employee of the employer, coupled with a periodic payment at a cents-per-mile rate to cover the operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of using an automobile for such purposes, is an allowance paid at a flat rate or stated schedule. Likewise, a periodic payment at a variable rate based on a stated schedule for different locales to cover the costs of driving an automobile in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

SECTION 5. BUSINESS STANDARD MILEAGE RATE

.01 *In general*. The standard mileage rate for transportation expenses is 34.5 cents per mile for all miles of use for business purposes. This business standard mileage rate will be adjusted annually (to the extent warranted) by the Service, and any such adjustment will be applied prospectively.

.02 *Use of the business standard mileage rate*. A taxpayer may use the business standard mileage rate with respect to an automobile that is either owned or leased by the taxpayer. A taxpayer generally may deduct an amount equal to either the business standard mileage rate times the number of business miles traveled or the actual costs (both operating and fixed) paid or incurred by the taxpayer that are allocable to traveling those business miles.

.03 *Business standard mileage rate in lieu of operating and fixed costs*. A deduction using the standard mileage rate for business miles is computed on a yearly basis and is in lieu of all operating and fixed costs of the automobile allocable to business purposes (except as provided in section 9.06 of this revenue procedure). Such items as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, and license and registration fees are included in operating and fixed costs for this purpose.

.04 *Parking fees, tolls, interest, and taxes*. Parking fees and tolls attributable to use of the automobile for business purposes may be deducted as separate items. Likewise, interest relating to the purchase of the automobile as well as state and local personal property taxes may be deducted as separate items, but only to the extent allowable under § 163 or 164, respectively. If the automobile is operated less than 100 percent for business purposes, an allocation is required to determine the business and nonbusiness portion of the taxes and interest deduction allowable. However, § 163(h)(2)(A) expressly provides that interest is nondeductible personal interest when it is paid or accrued on indebtedness properly allocable to the trade or business of performing services as an employee. Section 164 also expressly provides that state and local taxes that are paid or accrued by a taxpayer in connection with an acquisition or disposition of property will be treated as part of the cost of the acquired property or as a reduction in the amount realized on the disposition of such property.

.05 *Depreciation*. For owned automobiles placed in service for business purposes, and for which the business standard mileage rate has been used for any year, depreciation will be considered to have been allowed at the rate of 12 cents per mile for 1997, 1998, and 1999; 14 cents per mile for 2000; and 15 cents per mile for 2001, for those years in which the business standard mileage rate was used. If actual costs were used for one or more of those years, the rates above will not apply to any year in which such costs were used. The depreciation described above will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016.

.06 *Limitations*.

(1) The business standard mileage rate may not be used to compute the deductible expenses of (a) automobiles used for hire, such as taxicabs, or (b) two or more automobiles used simultaneously (such as in fleet operations).

(2) The business standard mileage rate may not be used to compute the deductible business expenses of an automobile leased by a taxpayer unless the taxpayer uses either the business standard mileage rate or a FAVR allowance (as provided in section 8 of this revenue procedure) to compute the deductible business expenses of the automobile for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(3) The business standard mileage rate may not be used to compute the deductible expenses of an automobile for which the taxpayer has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, or (c) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. By using the business standard mileage rate, the taxpayer has elected to exclude the automobile (if owned) from MACRS pursuant to § 168(f)(1). If, after using the business standard mileage rate, the taxpayer uses actual costs, the taxpayer must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(4) The business standard mileage rate and this revenue procedure may not be used to compute the amount of the deductible automobile expenses of an employee of the United States Postal Service incurred in performing services involving the collection and delivery of mail on a rural route if the employee receives qualified reimbursements (as defined in § 162(o)) for such expenses. See § 162(o) for the rules that apply to these qualified reimbursements.

SECTION 6. RESERVED

SECTION 7. CHARITABLE, MEDICAL, AND MOVING STANDARD MILEAGE RATE

.01 *Charitable*. Section 170(i) provides a standard mileage rate of 14 cents per mile for purposes of computing the charitable deduction for use of an automobile in connection with rendering gratuitous services to a charitable organization under § 170.

.02 *Medical and moving*. The standard mileage rate is 12 cents per mile for use of an automobile (a) to obtain medical care described in § 213, or (b) as part of a move for which the expenses are deductible under § 217. The standard mileage rates for medical and moving transportation expenses will be adjusted annually (to the extent warranted) by the Service, and any such adjustment will be applied prospectively.

.03 *Charitable, medical, or moving expense standard mileage rate in lieu of operating expenses*. A deduction computed using the applicable standard mileage rate for charitable, medical, or moving expense miles is in lieu of all operating expenses (including gasoline and oil) of the automobile allocable to such purposes. Costs for such items as depreciation (or lease payments), insurance, and license and registration fees are not deductible, and are not included in such standard mileage rates.

.04 *Parking fees, tolls, interest, and taxes*. Parking fees and tolls attributable to the use of the automobile for charitable, medical, or moving expense purposes may be deducted as separate items. Interest relating to the purchase of the automobile and state and local personal property taxes are not deductible as charitable, medical, or moving expenses, but they may be deducted as separate items to the extent allowable under § 163 or 164, respectively.

SECTION 8. FIXED AND VARIABLE RATE ALLOWANCE

.01 *In general*.

(1) The ordinary and necessary expenses paid or incurred by an employee in driving an automobile owned or leased by the employee in connection with the performance of services as an employee of the employer will be deemed substantiated (in an amount determined under section 9 of this revenue procedure) when a payor reimburses such expenses with a mileage allowance using a flat rate or stated schedule that combines periodic fixed and variable rate payments that meet all the requirements of section 8 of this revenue procedure (a FAVR allowance).

(2) The amount of a FAVR allowance must be based on data that (a) is derived from the base locality, (b) reflects retail prices paid by consumers, and (c) is reasonable and statistically defensible in approximating the actual expenses employees receiving the allowance would incur as owners of the standard automobile.

.02 *Definitions*.

(1) *FAVR allowance*. A FAVR allowance includes periodic fixed payments and periodic variable payments. A payor may maintain more than one FAVR allowance. A FAVR allowance that uses the same payor, standard automobile (or an automobile of the same make and model that is comparably equipped), retention period, and business use percentage is considered one FAVR allowance, even though other features of the allowance may vary. A FAVR allowance also includes any optional high mileage payments; however, such optional high mileage payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes when paid. See section 9.05 of this revenue procedure. An optional high mileage payment covers the additional depreciation for a standard automobile attributable to business miles driven and

substantiated by the employee for a calendar year in excess of the annual business mileage for that year. If an employee is covered by the FAVR allowance for less than the entire calendar year, the annual business mileage may be prorated on a monthly basis for purposes of the preceding sentence.

(2) *Periodic fixed payment*. A periodic fixed payment covers the projected fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving the standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. A periodic fixed payment may be computed by (a) dividing the total projected fixed costs of the standard automobile for all years of the retention period, determined at the beginning of the retention period, by the number of periodic fixed payments in the retention period, and (b) multiplying the resulting amount by the business use percentage.

(3) *Periodic variable payment*. A periodic variable payment covers the projected operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of driving a standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. The rate of a periodic variable payment for a computation period may be computed by dividing the total projected operating costs for the standard automobile for the computation period, determined at the beginning of the computation period, by the computation period mileage. A computation period can be any period of a year or less. Computation period mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a computation period and equals the retention mileage divided by the number of computation periods in the retention period. For each business mile substantiated by the employee for the computation period, the periodic variable payment must be paid at a rate that does not exceed the rate for that computation period.

(4) *Base locality*. A base locality is the particular geographic locality or region of the United States in which the costs of driving an automobile in connection with the performance of services as an employee of the employer are generally paid or incurred by the employee. Thus, for purposes of determining the amount of fixed costs, the base locality is generally the geographic locality or region in which the employee resides. For purposes of determining the amount of operating costs, the base locality is generally the geographic locality or region in which the employee drives the automobile in connection with the performance of services as an employee of the employer.

(5) *Standard automobile*. A standard automobile is the automobile selected by the payor on which a specific FAVR allowance is based.

(6) *Standard automobile cost*. The standard automobile cost for a calendar year may not exceed 95 percent of the sum of (a) the retail dealer invoice cost of the standard automobile in the base locality, and (b) state and local sales or use taxes applicable on the purchase of such an automobile. Further, the standard automobile cost may not exceed $27,100.

(7) *Annual mileage*. Annual mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a calendar year. Annual mileage equals the annual business mileage divided by the business use percentage.

(8) *Annual business mileage*. Annual business mileage is the mileage a payor reasonably projects a standard automobile will be driven by an employee in connection with the performance of services as an employee of the employer during the calendar year, but may not be less than 6,250 miles for a calendar year. Annual business mileage equals the annual mileage multiplied by the business use percentage.

(9) *Business use percentage*. A business use percentage is determined by dividing the annual business mileage by the annual mileage. The business use percentage may not exceed 75 percent. In lieu of demonstrating the reasonableness of the business use percentage based on records of total mileage and business mileage driven by the employees annually, a payor may use a business use percentage that is less than or equal to the following percentages for a FAVR allowance that is paid for the following annual business mileage:

Annual business mileage	*Business use percentage*
6,250 or more but less than 10,000	45 percent
10,000 or more but less than 15,000	55 percent
15,000 or more but less than 20,000	65 percent
20,000 or more	75 percent

(10) *Retention period*. A retention period is the period in calendar years selected by the payor during which the payor expects an employee to drive a standard automobile in connection with the performance of services as an employee of the employer before the automobile is replaced. Such period may not be less than two calendar years.

(11) *Retention mileage*. Retention mileage is the annual mileage multiplied by the number of calendar years in the retention period.

(12) *Residual value*. The residual value of a standard automobile is the projected amount for which it could be sold at the end of the retention period after being driven the retention mileage. The Service will accept the following safe harbor residual values for a standard automobile computed as a percentage of the standard automobile cost:

Retention period	*Residual value*
2-year	70 percent
3-year	60 percent
4-year	50 percent

.03 *FAVR allowance in lieu of operating and fixed costs*.

(1) A reimbursement computed using a FAVR allowance is in lieu of the employee's deduction of all the operating and fixed costs paid or incurred by an em-

ployee in driving the automobile in connection with the performance of services as an employee of the employer, except as provided in section 9.06 of this revenue procedure. Such items as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, license and registration fees, and personal property taxes are included in operating and fixed costs for this purpose.

(2) Parking fees and tolls attributable to an employee driving the standard automobile in connection with the performance of services as an employee of the employer are not included in fixed and operating costs and may be deducted as separate items. Similarly, interest relating to the purchase of the standard automobile may be deducted as a separate item, but only to the extent that the interest is an allowable deduction under § 163.

.04 *Depreciation.*

(1) A FAVR allowance may not be paid with respect to an automobile for which the employee has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, or (c) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. If an employee uses actual costs for an owned automobile that has been covered by a FAVR allowance, the employee must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(2) Except as provided in section 8.04(3) of this revenue procedure, the total amount of the depreciation component for the retention period taken into account in computing the periodic fixed payments for that retention period may not exceed the excess of the standard automobile cost over the residual value of the standard automobile. In addition, the total amount of such depreciation component may not exceed the sum of the annual § 280F limitations on depreciation (in effect at the beginning of the retention period) that apply to the standard automobile during the retention period.

(3) If the depreciation component of periodic fixed payments exceeds the limitations in section 8.04(2) of this revenue procedure, that section will be treated as satisfied in any year during which the total annual amount of the periodic fixed payments and the periodic variable payments made to an employee driving 80 percent of the annual business mileage of the standard automobile does not exceed the amount obtained by multiplying 80 percent of the annual business mileage of the standard automobile by the applicable business standard mileage rate for that year (see, *e.g.*, section 5.01 of this revenue procedure).

(4) The depreciation included in each periodic fixed payment portion of a FAVR allowance paid with respect to an automobile will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016. See section 8.07(2) of this revenue procedure for the requirement that the employer report the depreciation component of a periodic fixed payment to the employee.

.05 *FAVR allowance limitations.*

(1) A FAVR allowance may be paid only to an employee who substantiates to the payor for a calendar year at least 5,000 miles driven in connection with the performance of services as an employee of the employer or, if greater, 80 percent of the annual business mileage of that FAVR allowance. If the employee is covered by the FAVR allowance for less than the entire calendar year, these limits may be prorated on a monthly basis.

(2) A FAVR allowance may not be paid to a control employee (as defined in § 1.61–21(f)(5) and (6), excluding the $100,000 limitation in paragraph (f)(5)(iii)).

(3) At no time during a calendar year may a majority of the employees covered by a FAVR allowance be management employees.

(4) At all times during a calendar year at least five employees of an employer must be covered by one or more FAVR allowances.

(5) A FAVR allowance may be paid only with respect to an automobile (a) owned or leased by the employee receiving the payment, (b) the cost of which, when new, is at least 90 percent of the standard automobile cost taken into account for purposes of determining the FAVR allowance for the first calendar year the employee receives the allowance with respect to that automobile, and (c) the model year of which does not differ from the current calendar year by more than the number of years in the retention period.

(6) A FAVR allowance may not be paid with respect to an automobile leased by an employee for which the employee has used actual expenses to compute the deductible business expenses of the automobile for any year during the entire lease period. For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(7) The insurance cost component of a FAVR allowance must be based on the rates charged in the base locality for insurance coverage on the standard automobile during the current calendar year without taking into account such rate-increasing factors as poor driving records or young drivers.

(8) A FAVR allowance may be paid only to an employee whose insurance coverage limits on the automobile with respect to which the FAVR allowance is paid are at least equal to the insurance coverage limits used to compute the periodic fixed payment under that FAVR allowance.

.06 *Employee reporting.* Within 30 days after an employee's automobile is initially covered by a FAVR allowance, or is again covered by a FAVR allowance if such coverage has lapsed, the employee by written declaration must provide the payor with the following information: (a) the make, model, and year of the employee's automobile, (b) written proof of the insurance coverage limits on the automobile, (c) the odometer reading of the automobile, (d) if owned, the purchase price of the automobile or, if leased, the price at which the automobile is ordinarily sold by retailers (the gross capitalized cost of the automobile), and (e) if owned, whether the employee has claimed depreciation with respect to the automobile using any of the depreciation methods prohibited by section 8.04(1) of this revenue procedure or, if leased, whether the employee has computed deductible business expenses with respect to the automobile using actual expenses. The information described in (a), (b), and (c) of the preceding sentence also must be supplied

by the employee to the payor within 30 days after the beginning of each calendar year that the employee's automobile is covered by a FAVR allowance.

.07 *Payor recordkeeping and reporting*.

(1) The payor or its agent must maintain written records setting forth (a) the statistical data and projections on which the FAVR allowance payments are based, and (b) the information provided by the employees pursuant to section 8.06 of this revenue procedure.

(2) Within 30 days of the end of each calendar year, the employer must provide each employee covered by a FAVR allowance during that year with a statement that, for automobile owners, lists the amount of depreciation included in each periodic fixed payment portion of the FAVR allowance paid during that calendar year and explains that by receiving a FAVR allowance the employee has elected to exclude the automobile from MACRS pursuant to § 168(f)(1). For automobile lessees, the statement must explain that by receiving the FAVR allowance the employee may not compute the deductible business expenses of the automobile using actual expenses for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

.08 *Failure to meet section 8 requirements*. If an employee receives a mileage allowance that fails to meet one or more of the requirements of section 8 of this revenue procedure, the employee may not be treated as covered by any FAVR allowance of the payor during the period of such failure. Nevertheless, the expenses to which that mileage allowance relates may be deemed substantiated using the method described in sections 5, 9.01(1), and 9.02 of this revenue procedure to the extent the requirements of those sections are met.

SECTION 9. APPLICATION

.01 If a payor pays a mileage allowance in lieu of reimbursing actual transportation expenses incurred or to be incurred by an employee, the amount of the expenses that is deemed substantiated to the payor is either:

(1) for any mileage allowance other than a FAVR allowance, the lesser of the amount paid under the mileage allowance or the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee; or

(2) for a FAVR allowance, the amount paid under the FAVR allowance less the sum of (a) any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return to the payor although required to do so, (b) any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return to the payor although required to do so, and (c) any optional high mileage payments.

.02 If the amount of transportation expenses is deemed substantiated under the rules provided in section 9.01 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place (or use), and business purpose of the transportation expenses in accordance with paragraphs (b)(2) (travel away from home), (b)(6) (listed property, which includes passenger automobiles and any other property used as a means of transportation), and (c) of § 1.274–5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5(f), as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5(c). See § 1.62–2(e)(1) for the rule that an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.03 An arrangement providing mileage allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) with respect to returning amounts in excess of expenses as follows:

(1) For a mileage allowance other than a FAVR allowance, the requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of such an allowance that relates to miles of travel not substantiated by the employee, even though the arrangement does not require the employee to return the portion of such an allowance that relates to the miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance mileage allowance of $80 based on an anticipated 200 business miles at 40 cents per mile (at a time when the applicable business standard mileage rate is 34.5 cents per mile), and the employee substantiates 120 business miles. The requirement to return excess amounts will be treated as satisfied if the employee is required to return the portion of the allowance that relates to the 80 unsubstantiated business miles ($32) even though the employee is not required to return the portion of the allowance ($6.60) that exceeds the amount of the employee's expenses deemed substantiated under section 9.01 of this revenue procedure ($41.40) for the 120 substantiated business miles. However, the $6.60 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 9.05.

(2) For a FAVR allowance, the requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)), (a) the portion (if any) of the periodic variable payment received that relates to miles in excess of the business miles substantiated by the employee, and (b) the portion (if any) of a periodic fixed payment that relates to a period during which the employee was not covered by the FAVR allowance.

.04 An employee is not required to include in gross income the portion of a mileage allowance received from a payor that is less than or equal to the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02. *See* § 1.274–5(f)(2)(i). In addition, such portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W-2, and is exempt from the withholding and payment of employment taxes. *See* §§ 1.62–2(c)(2) and (c)(4).

.05 An employee is required to include in gross income only the portion of a mileage allowance received from a payor that exceeds the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee sub-

stantiates in accordance with section 9.02 of this revenue procedure. *See* § 1.274–5(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. *See* §§ 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.06

(1) Except as otherwise provided in section 9.06(2) of this revenue procedure with respect to leased automobiles, if the amount of the expenses deemed substantiated under the rules provided in section 9.01 of this revenue procedure is less than the amount of the employee's business transportation expenses, the employee may claim an itemized deduction for the amount by which the business transportation expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business transportation expenses, includes on Form 2106, Employee Business Expenses, the deemed substantiated portion of the mileage allowance received from the payor, and includes in gross income the portion (if any) of the mileage allowance received from the payor that exceeds the amount deemed substantiated. *See* § 1.274–5(f)(2)(iii). However, for purposes of claiming this itemized deduction, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the applicable standard mileage rate multiplied by the number of business miles substantiated by the employee minus the amount deemed substantiated under section 9.01 of this revenue procedure. The itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

(2) An employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(1) of this revenue procedure (relating to an allowance other than a FAVR allowance) may not claim a deduction based on actual expenses unless the employee does so consistently beginning with the first business use of the automobile after December 31, 1997. However, an employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(2) of this revenue procedure (relating to a FAVR allowance) may not claim a deduction based on actual expenses.

.07 An employee may deduct an amount computed pursuant to section 5.01 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.08 A self-employed individual may deduct an amount computed pursuant to section 5.01 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.09 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. Thus, such payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes. *See* §§ 1.62–2(c)(3), (c)(5), and (h)(2).

SECTION 10. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES.

.01 The portion of a mileage allowance (other than a FAVR allowance), if any, that relates to the miles of business travel substantiated and that exceeds the amount deemed substantiated for those miles under section 9.01(1) of this revenue procedure is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

(1) In the case of a mileage allowance paid as a reimbursement, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the business miles substantiated. *See* § 1.62–2(h)(2)(i)(B)(2).

(2) In the case of a mileage allowance paid as an advance, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the business miles with respect to which the advance was paid are substantiated. *See* § 1.62–2(h)(2)(i)(B)(3). If some or all of the business miles with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those miles within a reasonable period of time, the portion of the allowance that relates to those miles is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. *See* § 1.62–2(h)(2)(i)(A).

(3) In the case of a mileage allowance that is not computed on the basis of a fixed amount per mile of travel (*e.g.*, a mileage allowance that combines periodic fixed and variable rate payments, but that does not satisfy the requirements of section 8 of this revenue procedure), the payor must compute periodically (no less frequently than quarterly) the amount, if any, that exceeds the amount deemed substantiated under section 9.01(1) of this revenue procedure by comparing the total mileage allowance paid for the period to the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee for the period. Any excess is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. *See* § 1.62–2(h)(2)(i)(B)(4).

(4) For example, assume an employer pays its employees a mileage allowance at a rate of 40 cents per mile (when the business standard mileage rate is 34.5 cents per mile). The employer does not require the return of the portion of the allowance that exceeds the business standard mileage rate for the business miles substantiated (5.5 cents). In June, the employer advances an employee $200 for 500 miles to be traveled during the month. In July, the employee substantiates to the employer 400 business miles traveled in June and returns $40 to the employer for the 100 business miles not traveled. The amount deemed substantiated for the 400 miles traveled is $138 and the employee is not required to return the remaining $22. No later than the first payroll period following the payroll period in which the 400 business miles traveled are substantiated, the employer must

withhold and pay employment taxes on $22.

.02 The portion of a FAVR allowance, if any, that exceeds the amount deemed substantiated for those miles under section 9.01(2) of this revenue procedure is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

(1) Any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return within a reasonable period, or any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return within a reasonable period, is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. *See* § 1.62–2(h)(2)(i)(A).

(2) Any optional high mileage payment is subject to withholding and payment of employment taxes when paid.

SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–38, 1999–43 I.R.B. 525, is hereby superseded for mileage allowances that are paid both (1) to an employee on or after January 1, 2001, and (2) with respect to transportation expenses paid or incurred by the employee on or after January 1, 2001. Rev. Proc. 99–38 is also hereby superseded for purposes of computing the amount allowable as a deduction for transportation expenses paid or incurred on or after January 1, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Edwin B. Cleverdon of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Cleverdon at (202) 622-4920 (not a toll-free call).

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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